

**DEPARTMENT OF INSURANCE, FINANCIAL
INSTITUTIONS AND PROFESSIONAL REGISTRATION**

P.O. Box 690, Jefferson City, Mo. 65102-0690

In Re:)
)
Travelers' Rate Filing for the) **DIFP Case No. 100524466C**
Workers' Compensation Assigned Risk Plan)

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

This matter concerns proposed changes to the rates and rating structure to be used in the Missouri Alternative Residual Market Plan ("A.R.M. Plan" or "Plan") beginning July 1, 2010. The A.R.M. Plan was created under the authority of § 287.896, RSMo, and 20 CSR 500-6.960 as a mechanism to provide workers' compensation and employer's liability insurance to applicants who are in good faith entitled to such coverage but who are unable to purchase such coverage by ordinary methods through the voluntary market. The A.R.M. Plan began operation on July 1, 1995, and is currently administered by Travelers Commercial Casualty Company ("Travelers"), which was selected by the Department of Insurance, Financial Institutions and Professional Registration ("DIFP" or "Department") as the Contract Carrier following a Request for Proposal issued in November, 2006.

In accordance with the A.R.M. Plan, Travelers submitted its proposed rate filing ("Filing") with the Department on March 15, 2010, by which it sought rate changes for the new contract period beginning July 1, 2010. On that same date, Travelers also filed its proposal for manual rates at the detail class code level and its proposed changes to minimum premiums by classification.

As required under § 287.896, RSMo, a public hearing was held concerning the Travelers' Filing. The hearing was conducted at the Department's Jefferson City offices on May 26, 2010. Travelers introduced the various documents that constituted its Filing into evidence, explained them and answered questions from the Department, through the testimony of Jonathan B. Hale, FCAS, MAAA, Vice President and Actuary for Travelers. The Department's staff actuary, David B. Cox, FCAS, MAAA, provided testimony regarding the Travelers Filing.

FINDINGS OF FACT

1. Effective Date: If approved, the premium rate changes proposed in Travelers' Filing will go into effect on July 1, 2010.

2. Expert Witnesses: Both Mr. Hale and Mr. Cox demonstrated that they are qualified to provide expert testimony regarding workers' compensation residual market rate matters.

3. Indicated Premium Need: At the 100% loss ratio retention level option authorized by 20 CSR 500-6.960, Travelers' Filing proposes changes to the existing A.R.M. Plan rates and rating structure which would result in an overall premium level decrease of 1.4%. This proposed premium level increase was requested by Travelers based on its analysis of the Plan's "premium need" for the upcoming contract year of July 1, 2010 to June 30, 2011. This premium need analysis compared the expenses likely to be incurred by the Plan during this upcoming period with the premium likely to be received during the same period (without any premium increase or decrease). This analysis revealed that the premium likely to be available to Travelers would exceed the likely expenses of the Plan by 1.4%. The various expense items included in this premium need analysis were summarized at Section II, page 2 of Travelers' Filing, which indicated the following:

| <u>Cost Items</u> | <u>Estimated % of Premium</u> |
|---|-------------------------------|
| 1. Expected On-Level Loss & ALAE Ratio | 65.0% |
| 2. General Expenses (Excluding Commissions) | 15.5% |
| 3. Unallocated Loss Adjustment Expenses | 4.5% |
| 4. Agents' Commissions | 4.0% |
| 5. Loading for Taxes, Licenses & Fees | 2.5% |
| 6. Loading for Uncollectible Premiums | 5.0% |
| 7. Catastrophic Provision-Certified Terrorism | 0.3% |
| 8. Loading for Profit and Contingencies | 2.0% |

Using the item numbers from the Cost Items listed above and their corresponding premium percentages, the premium level need calculation is set forth below.

$$\frac{[(\text{Cost Item 1} + \text{Cost Item 2} + \text{Cost Item 3} + \text{Cost Item 7})]}{(1 - \text{Cost Item 4} - \text{Cost Item 5} - \text{Cost Item 6} - \text{Cost Item 8})} - 1.00 = \text{Premium Level Need}$$

$$\begin{aligned} & \frac{[(0.65 + 0.155 + 0.045 + 0.003)]}{(1 - 0.04 - 0.025 - 0.05 - 0.02)} - 1.00 = -0.014 \\ & = -1.4\% \end{aligned}$$

Findings of Fact 4 through 11, below, discuss in more detail Travelers' explanation for each of the eight Cost Items listed above.

4. Expected On-Level Loss & ALAE Ratio: The methodology used by Travelers in its rate request was to take an average of historical loss and loss adjustment expense data from prior years as a means of estimating the likely loss and allocated loss adjustment expenses ("ALAE") for the upcoming contract year. The bulk of the spreadsheets contained in the Filing represent the steps needed to arrive at this estimate of loss and ALAE. Travelers ties all these steps together to produce the loss and ALAE level of 65.0% for the upcoming year used in Travelers' premium level need calculation (See Filing Section III, page 2). Travelers selected a trend factor for this year of -0.3% (See Filing Section VII, page 2).

Mr. Hale testified that Travelers' favorable claims experience was offset somewhat by the continuous depopulation of the residual market since the 2004 contract year.

5. General Expenses (Excluding Commissions): Many of the remaining elements of Travelers' premium level need calculation are related to the less-variable fixed or imbedded costs associated with administering the Plan. Cost Item 2 of the calculation concerns General Expenses (Excluding Commissions). Page 2 of Section VIII of Travelers' Filing sets forth the various anticipated expense levels contemplated by General Expenses for the upcoming contract period:

| | | |
|---|--------------------|----------------|
| | 2010 Filing | |
| Estimated Premium (2010 Contract Year): | \$11,364,000 | |
| Estimated No. of Insureds (2010 Contract Year): | 2,500 | |
| | Amount | % of |
| <u>Category of General Expense</u> | <u>(,000)</u> | <u>Premium</u> |
| Underwriting, Policy Issuance & Rating/Billing | \$640 | 5.6% |
| Missouri Injury Management Program | 125 | 1.1% |
| Data Processing | 543 | 4.8% |
| Premium Audit | 271 | 2.4% |
| Loss Control and Prevention | 170 | 1.5% |
| Actuarial, Finance, and Human Resources | 86 | 0.8% |
| Other Overhead | <u>400</u> | <u>3.5%</u> |
| Total | \$2,235 | 19.7% |

The indicated General Expense provision being used in the Travelers' Filing has been capped at 15.5% of premium, in accordance with the Missouri A.R.M. Contract Modification effective on 7/1/2008. That modification requires that the General Expense and Unallocated Loss Adjustment (ULAE) and Expenses provision in the filing not exceed 20% of premium.

6. Unallocated Loss Adjustment Expense: Travelers based the A.R.M. Plan's ULAE calculation on the ULAE percentage filed with the Department by the National Council on Compensation Insurance, Inc. (NCCI) in its "Missouri Voluntary Loss Costs" 1/1/2010 filing; that number was 7.8%. From that number, Travelers calculated the A.R.M. Plan's ULAE for medical and indemnity claims as 4.5% of premium (Filing Section VIII, p. 4) for the upcoming contract year.

7. Loading for Taxes, Licenses & Fees: Travelers anticipated paying taxes, licenses and fees at the equivalent of 2.5% of premium. The amount includes premium to pay the current Missouri Workers' Compensation Administrative Tax, the Missouri Property and Casualty Guaranty Fund assessment, and miscellaneous taxes such as personal property taxes, National Association of Insurance Commissioners (NAIC) zone examinations, and agent license fees. (See Filing Section VIII, p. 5)

8. Agents' Commissions: Travelers compared its A.R.M. premium for fifteen previous contract periods with the agent commissions it paid in those periods, and then calculated the corresponding commission "rates." Travelers selected 4.0% for the upcoming contract period based on historical commissions. (See Filing Section VIII, p. 6)

9. Loading for Uncollectible Premium: The Filing provides the history of uncollectible premiums for the A.R.M. Plan on Page 7 of Section VIII. Travelers calculated several different weighted averages, and finally selected -5.0% for contract year 2010.

10. Catastrophic Provision – Certified Terrorism Losses: Since 2003, Travelers has included a catastrophic provision for foreign terrorism losses of 0.02 per \$100 of payroll. The Filing decreases this provision to 0.01 per \$100 of payroll. This amount of terrorism funding represented 0.3% of the premium in the A.R.M. Plan. (See Filing Section IX, p. 1)

11. Profit & Contingency: The Filing includes Cost Item 8 ("Loading for Profit and Contingencies"), with a profit load of 2.0% of premium. Mr. Cox testified that the proposed rates are expected to produce an after-tax return on surplus that is consistent with industry norms.

12. Proposed Allocation of a Rate Increase Among Class Codes: Travelers' Filing included a proposal for manual rates at the detail class code level. The proposal attempts to better align the overall rates with the voluntary market loss costs filed by the NCCI that became effective on 1/1/2010.

According to Travelers, the rates will align with NCCI loss costs except in instances where they have deemed the premium impact to be too severe to be taken at once. To avoid large rate increases to employers, Travelers proposes that increases be capped at 15%, plus 25% of the difference between the indicated rate change and +15%. In addition, decreases are capped at -15% plus 25% of the difference between the indicated rate change and -15%.

13. Proposed Changes to Minimum Premiums by Classification: Travelers proposed changes to minimum policy premiums by classification, beginning with the July 1, 2009 rate filing. Travelers proposed to increase the maximum minimum premium from \$750 to \$1,000, to be phased in over a two year period. The first half of this change became effective on July 1, 2009, and increased the maximum minimum premium to \$875. In this filing, Travelers is proposing to raise the maximum minimum premium to \$1,000, effective July 1, 2010.

Travelers also proposed changes to the minimum premium multiplier, to be phased in over a two year period. The first half of the increase became effective July 1, 2009, and increased the

minimum premium multiplier to 262.5. This filing proposes to increase the minimum premium multiplier to 350, effective July 1, 2010. Both of these changes are estimated to increase the A.R.M. premium by + 0.7% for the contract year beginning July 1, 2010.

14. The Department's Actuarial Analysis of Premium Level Need: Travelers' actuary, Jonathan Hale, testified that the proposed rates were neither excessive nor inadequate, nor were they unfairly discriminatory. The Department's actuary, David Cox, also reviewed the Filing and testified that the rates were not inadequate, excessive, or unfairly discriminatory. Mr. Cox recommended that the proposed rates be approved.

CONCLUSIONS OF LAW

Based on the evidence provided by Travelers and the Department, and the testimony before the Department on May 26, 2010, the Director has reached the following conclusions:

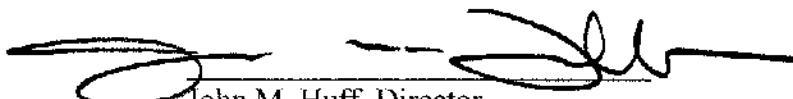
1. The subject matter of Travelers' Filing, and the hearing held by the Department of Insurance, Financial Institutions and Professional Registration on said Filing on May 26, 2010, are within the jurisdiction of the Director under § 287.896, RSMo.
2. July 1, 2010, is a reasonable date for new premium rates and rating structures authorized pursuant to this Order for new and renewal business in the Missouri residual market.
3. Travelers' proposed 1.4% premium level decrease at the proposed 100% loss ratio retention level option, together with its proposed rate relativity capping methodology and its proposed changes to the minimum premiums by classification will produce a level of premium, investment income and final premium rates which are not excessive, inadequate, or unfairly discriminatory and which will be actuarially sufficient to cover the claims, losses, and reasonable operating expenses of the Missouri residual market under the A.R.M. Plan.

ORDER

IT IS THEREFORE ORDERED that the rates and supplemental rate information, as proposed by Travelers, for use in the A.R.M. Plan beginning July 1, 2010, as set forth above, are hereby approved.

SO ORDERED, SIGNED AND OFFICIAL SEAL AFFIXED THIS 15TH DAY OF
JUNE, 2010.




John M. Huff, Director
Missouri Department of Insurance,
Financial Institutions and
Professional Registration

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing, was served
by U.S. mail, postage prepaid, on this 15th day of June, 2010 to:

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Hand Delivered to:

James Morris
Senior Counsel
Insurance Market Regulations Division
Missouri Department of Insurance, Financial Institutions & Professional Registration

A handwritten signature in cursive script, appearing to read "James Morris", is written over a horizontal line.